

FILED & ENTERED

AUG 22 2017

CLERK U.S. BANKRUPTCY COURT  
Central District of California  
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# NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

NORTHERN DIVISION

In re:

LA CASA DE LA RAZA, INC.,

Debtor.

Case. No. 9:16-bk-10331-PC

Adversary No. 9:16-ap-01040-PC

Chapter 11

LA CASA DE LA RAZA, INC.,

Plaintiff,

v.

TOMAS COSTELO, ESQ., an Individual;  
MLG LEASING, INC., a California  
Corporation, et al.,

Defendants.

**MEMORANDUM RE: PLAINTIFF'S  
MOTION FOR DEFAULT  
JUDGMENT AGAINST DEFENDANT,  
TOMAS CASTELO**

Date: May 3, 2017

Time: 1:30 p.m.

Place: United States Bankruptcy Court  
Courtroom # 201  
1415 State Street  
Santa Barbara, CA 93101

At the above captioned date and time, the court considered the motion of Plaintiff, La Casa De La Raza, Inc. ("La Casa") for a default judgment against the remaining Defendant,

1 Tomas A. Castelo (“Castelo”)<sup>1</sup> in the above referenced adversary proceeding. Having  
2 considered the record<sup>2</sup> and argument of counsel, the court will recommend to the district court  
3 that La Casa’s Motion be denied and that La Casa’s First and Sixth Causes of Action against  
4 Castelo, together with La Casa’s claim for equitable subordination, be dismissed with prejudice  
5 based upon the following findings of fact and conclusions of law made pursuant to F.R.Civ.P.  
6 52(a)(1),<sup>3</sup> as incorporated into FRBP 7052 and applied to adversary proceedings in bankruptcy  
7 cases.<sup>4</sup>

#### 8 STATEMENT OF FACTS

9 On February 23, 2016, La Casa filed a voluntary petition in the above referenced case. In  
10 Schedule D, La Casa listed MLG Leasing, Inc. (“MLG”) as the holder of a claim in the amount  
11 of \$500,000 secured by real property at 601 E. Montecito Street, Santa Barbara, CA (“Santa  
12 Barbara Property”) valued at \$3,000,000. On July 13, 2016, MLG filed Proof of Claim # 3  
13 asserting a secured claim in the amount of \$576,075.83 for “[m]oney loaned.” Castelo, a lawyer,  
14 is the Chief Executive Officer, Chief Financial Officer, Secretary and sole Director of MLG.

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16 <sup>1</sup> The Defendant’s name is “Tomas A. Castelo,” although La Casa’s complaint refers to him  
17 interchangeably as “Tomas Costello,” Thomas Costello,” and Tomas Castelo.”

18 <sup>2</sup> The record before the court includes the following: (1) Motion for Default Judgment:  
19 Memorandum of Points and Authorities; Declarations in Support Thereof (“Motion”) [Dkt # 88]  
20 filed February 28, 2017, consisting of La Casa’s motion, memorandum of points and authorities,  
21 Declaration of Matthew Clarke (“Clark Decl.”), Declaration of Marisela Marquez (“Marquez  
22 Decl.”), Declaration of Raquel Lopez (“Lopez Decl.”) and Exhibits A-F to the Motion; (2) the  
23 testimony of Matthew Clark, Marisela Marquez, Raquel Lopez, Michael Gonzalez and Luis  
24 Villegas at the hearing on May 3, 2017, and (3) Exhibits A through Z and Exhibits 1 through 6  
25 admitted into evidence at the hearing on May 3, 2017.

26 <sup>3</sup> Unless otherwise indicated, all “Code,” “chapter” and “section” references are to the  
27 Bankruptcy Code, 11 U.S.C. §§ 101-1330. “Rule” references are to the Federal Rules of  
28 Bankruptcy Procedure (“FRBP”), which make applicable certain Federal Rules of Civil  
Procedure (“F.R.Civ.P.”). “LBR” references are to the Local Bankruptcy Rules of the United  
States Bankruptcy Court for the Central District of California (“LBR”).

<sup>4</sup> This Memorandum Decision constitutes the bankruptcy court’s proposed findings of fact and  
conclusions of law for purposes of 28 U.S.C. § 157(c)(1). This Memorandum Decision will be  
transmitted to the United States District Court for entry of a final order or judgment after de novo  
review pursuant to 28 U.S.C. § 157(c)(1).

On May 5, 2016, La Casa filed the Complaint against Castelo and MLG in this adversary proceeding alleging six causes of action: (1) a determination of the validity and priority of liens; (2) intentional interference with a prospective economic advantage; (3) breach of contract; (4) breach of the covenant of good faith and fair dealing; (5) promissory estoppel; and (6) fraud.<sup>5</sup> La Casa sought a declaratory judgment, actual and punitive damages, and injunctive relief. On June 6, 2016, Castelo and MLG each filed an answer to La Casa's Complaint. La Casa then initiated discovery, but Castelo largely ignored La Casa's discovery requests. On September 15, 2016, the court ordered Castelo to respond but Castelo did not comply with the order. On November 3, 2016, the court sanctioned Castelo for violating the court's earlier September 15th order, struck his answer, and entered his default.<sup>6</sup> On January 12, 2017, La Casa moved to dismiss MLG as a defendant in the adversary proceeding without prejudice. After notice and a hearing, an order was entered dismissing MLG as a party to the case on February 9, 2017.

On February 28, 2017, La Casa moved ex parte for a default judgment against Castelo on its first and sixth causes of action, as well as a claim of equitable subordination. By order entered on March 6, 2017, the court denied La Casa's ex parte motion and set the matter for a status conference. At the status conference on March 23, 2017, the court set the motion for an evidentiary hearing on May 3, 2017.

On May 3, 2017, the court heard the testimony of Matthew Clark, Marisela Marquez, Raquel Lopez, Michael Gonzalez and Luis Villegas and admitted further exhibits into evidence. At the conclusion of the hearing, the matter was taken under submission.

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<sup>5</sup> Complaint of La Casa De La Raza, Inc., For: 1) Determination of Validity and Priority of Liens; (2) Intentional Interference With Prospective Economic Advantage; (3) Breach of Contract; (4) Breach of Covenant of Good Faith and Fair Dealing; (5) Unfair Business Practices; (6) Fraud ("Complaint") [Dkt. # 1] filed May 5, 2016.

<sup>6</sup> Order on Plaintiff's Motion for an Order: (1) for Sanctions against Defendants Jointly and Severally; (2) Entry of Default of Both Defendants ("Sanctions Order") [Dkt. # 37] entered November 3, 2016. By order entered on December 8, 2016, the court modified the Sanctions Order to vacate the entry of default against MLG. On December 21, 2016, MLG and Castelo appealed the Sanctions Order. The appeal is currently pending before the United States District Court in Case No. 2:16-cv-09437-AB. There is no stay of the Sanctions Order pending appeal.

II. DISCUSSION

This court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. §§ 157(b) and 1334(b). This matter is a non-core proceeding as to Castelo.<sup>7</sup> Venue is appropriate in this court. 28 U.S.C. § 1409(a).

1. Standard for Default Judgment

“The general rule is that upon default the factual allegations of the complaint, except those relating to the amount of damages, will be taken as true.” Geddes v. United Fin. Group, 559 F.2d 557, 560 (9th Cir. 1977). But an entry of default “does not automatically entitle a plaintiff to entry of a default judgment, regardless of the fact that generally the effect of entry of a default is to deem allegations admitted.” Beltran v. Wells Fargo Bank (In re Beltran), 182 B.R. 820, 823 (9th Cir. BAP 1995). The court is authorized to conduct a hearing on the issue of damages before entering a judgment by default. F.R.Civ.P. 55(b). The court also has broad discretion to require that a plaintiff establish the facts necessary to show that a valid claim exists meriting the relief sought against the defaulting party. See Beltran, 182 B.R. at 824 (“Bankruptcy courts are accordingly provided the discretion to require proof of the facts necessary to determine a valid claim for relief against the defaulting parties.”).

2. Sixth Cause of Action – Fraud

Under California law fraud is established upon proof of the following elements: “(1) misrepresentation (false representation,<sup>8</sup> concealment, or nondisclosure); (2) knowledge of

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<sup>7</sup> Castelo admits in his answer that this court has jurisdiction of this adversary proceeding, and states that the adversary proceeding is a core proceeding. Answer of Defendant Tomas Castelo [Dkt. # 6] filed June 6, 2016. However, La Casa is alleging claims against Castelo that arise under state law. Castelo is neither a creditor of La Casa nor has he filed a proof of claim or otherwise entered an appearance in La Casa’s bankruptcy case. Moreover, Castelo does not consent to entry of final orders or a final judgment in this adversary proceeding. See Joint Status Report [Dkt. # 12] filed July 18, 2016.

<sup>8</sup> “A false representation is an express misrepresentation, while a false pretense refers to an implied misrepresentation or ‘conduct intended to create and foster a false impression.’” Nat’l Bank of N. Am. V. Newmark (In re Newmark), 20 B.R. 842, 854 (Bankr. E.D.N.Y. 1982) (quoting H.C. Prange Co. v. Schnore (In re Schnore), 13 B.R. 249, 251 (Bankr. W.D. Wis. 1981)).

1 falsity (or scienter); (3) intent to defraud (i.e., to induce reliance); (4) justifiable reliance; and (5)  
2 resulting damage.” Hoffman v. 162 North Wolfe LLC, 228 Cal.App.4th 1178, 1185-86 (2014)  
3 (citation omitted). “[T]o establish a cause of action for fraud a plaintiff must plead and prove in  
4 full, factually and specifically, all of the elements of the cause of action.” Conrad v. Bank of  
5 Am., 45 Cal.App.4th 133, 156 (1996).

6 “A fraud claim based upon the suppression or concealment of a material fact must  
7 involve a defendant who has a legal duty to disclose the fact.” Hoffman, 228 Cal.App.4th at  
8 1186. ““There are four circumstances in which the nondisclosure or concealment may constitute  
9 actionable fraud: (1) when the defendant is in a fiduciary relationship with the plaintiff; (2) when  
10 the defendant has exclusive knowledge of material facts not known to the plaintiff; (3) when the  
11 defendant actively conceals a material fact from the plaintiff; and (4) when the defendant makes  
12 partial representations but also suppresses material facts.” Id. (citations omitted). “[F]raudulent  
13 intent may be established by circumstantial evidence or by inferences drawn from his or her  
14 course of conduct.” Fogel Legware of Switzerland, Inc. v. Wills (In re Wills), 243 B.R. 58, 62  
15 (9th Cir. BAP 1999).

16 In the Complaint’s sixth cause of action for fraud, La Casa claims that Castelo made the  
17 following false representations to La Casa upon which it justifiably relied to its detriment:

- 18 a. Mr. Castelo promised he would reinstate the loan so that La Casa was in good  
19 standing. This would allow La Casa to pursue a loan with the Santa Barbara  
20 Foundation.
- 21 b. Mr. Castelo indicated to La Casa that he could and would help with La Casa’s  
22 financial troubles. He claimed that he had done so before and would do it again.
- 23 c. On Saturday, September 19, 2015, Mr. Castelo indicated that he had helped La Casa  
24 financially on previous occasions and he would do it again.
- 25 d. When questioned about his motives, Mr. Castelo stated that he wanted nothing more  
26 than to assist La Casa financially, because, “I already have enough headaches in my  
27 life.”
- 28 e. Mr. Castelo promised that he had no interest in becoming involved in the  
management or finances of La Casa.

- 1 f. Mr. Castelo promised that he would not foreclose on the La Casa property and that a  
2 provision allowing him to do so was leftover from another version of the agreement.  
“It is not my intention to continue with the foreclosure action . . . .”
- 3 g. Mr. Castelo promised to provide a bridge loan. “This will become a ‘Bridge Loan’  
4 transaction, a common practice utilized to avoid the expiration of third party time  
5 constraints imposed upon the parties.”
- 6 h. “[La Casa is] being afforded the opportunity to pursue meaningful solutions, on a fair  
7 and reasonable timetable . . . .”
- 8 i. “I am in the process of downsizing my holdings and have little interest in adding  
9 another burden to my holdings and a foreclosure sale is at the bottom of my list of  
10 options. You may conduct yourselves accordingly.”<sup>9</sup>

11 According to the evidence, La Casa executed a promissory note in the original principal  
12 sum of \$440,000, payable to Nelson Shrager or Steve Shrager, as Trustees FBO the Budget  
13 Industrial Uniform Supply, Inc. Profit Sharing Plan, et al., dated June 6, 2012 (“Fidelity Note”),  
14 which was serviced by Fidelity Mortgage Lenders, Inc. (“Fidelity”). The Fidelity Note was  
15 secured by a Deed of Trust of even date therewith encumbering the Santa Barbara Property  
16 (“Deed of Trust”). When La Casa defaulted under the Fidelity Note, a notice of default was  
17 recorded followed by a notice that the Santa Barbara Property would be sold under the Deed of  
18 Trust at a foreclosure sale. La Casa retained Matthew Clarke (“Clarke”), an attorney, to assist it  
19 in obtaining three forbearance agreements to postpone of the foreclosure sale while it attempted  
20 to secure funds necessary to either pay off the loan entirely or bring the loan current.

21 When the third forbearance agreement expired, Clarke obtained a temporary restraining  
22 order to postpone the sale set for September 28, 2015, but was unsuccessful in securing a  
23 temporary injunction to halt Fidelity’s efforts to foreclose its deed of trust lien on the Santa  
24 Barbara Property. On September 16, 2015, Fidelity provided La Casa with a letter entitled  
25 “Beneficiary’s Demand for Payoff” which disclosed that the balance due and owing on the  
26 Fidelity Note as of September 25, 2015, was \$522,314.28, which included \$417,790.71 in  
27 principal, accrued interest of \$20,953.52 from March 15, 2015 to September 25, 2015, and  
28 \$83,570.05 in accrued late charges, unpaid charges and other fees.

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<sup>9</sup> Complaint, 21:1-24.

1 At the hearing on May 3, 2017, Michael Gonzales, La Casa's current President, testified  
2 that he has known Castelo since 1971; that Castelo was La Casa's first executive director; and  
3 that Castelo has been, and continues to be, an attorney for La Casa. Clarke testified that while  
4 the foreclosure was pending, Castelo contacted Wayne S. Grajewski, attorney for Fidelity, and  
5 Marisela Marquez ("Marquez"), who was La Casa's President at the time of the foreclosure,  
6 regarding the status of the Fidelity Note.

7 In his declaration dated February 27, 2017, Clarke testified that on September 19, 2015,  
8 Castelo offered to "reinstate the loan so that La Casa would be in good standing so it could get a  
9 loan from The Santa Barbara Foundation." When asked by Clarke why he was offering to help,  
10 Castelo responded that "he wanted nothing more than to assist La Casa financially, because, 'I  
11 already have enough headaches in my life.'" Clarke further testified by declaration that:

12 5. Mr. Castelo told me that La Casa would have to submit to him financial records  
13 and he would provide a Commercial Loan Commitment Letter. Mr. Castelo to  
14 [sic] me by email a sample Commercial Loan Commitment Letter to La Casa to  
15 illustrate what he was willing to do. Mr. Castelo also requested documents  
16 reflecting the current loan, billing statements and La Casa financial statements.  
La Casa, through me, provided the information to Mr. Castelo on September 21,  
2015, at 10:55 a.m.

17 6. Pursuant to Mr. Castelo's request, La Casa submit the Commercial Loan  
18 Commitment Letter, through me, to Mr. Castelo on September 21, 2015, at 1:46  
19 p.m. reflecting a loan of \$125,000, which was sufficient to reinstate the Fidelity  
20 loan. Mr. Castel [sic] told me on September 21, 2015, at 2:04 p.m., that "I have  
21 received and downloaded 29 files from your link – I will not have time to review  
these documents nor your proposed loan commitment letter until sometime  
tomorrow due to deadlines for work commitments for some of my other clients."

22 7. On September 22, 2015, I told Mr. Castelo that a foreclosure sale was  
23 scheduled for September 28, 2015. Mr. Castelo asked me that he be placed in  
24 contact with the lender via conference call with La Casa. La Casa introduced Mr.  
25 Castelo, as their attorney, to Wayne Grajewski, an attorney who represented  
Fidelity. I know that Mr. Castelo contacted Mr. Grajewski by telephone,  
presumably to begin negotiations on behalf of his client, La Casa.

26 8. On September 22, 2015, at 4:42 p.m., Mr. Castelo wrote to Mr. Grajewski and  
27 copied me, stating . . . "I am prepared to wire \$523K tomorrow morning if we can  
28 get your timely approvals."

1 9. On September 22, 2015, at 8:12 p.m., Mr. Castelo set a draft Loan Sale  
2 agreement and draft Assumption of Deed to me, on behalf of La Casa and Mr.  
3 Grajewski. I was pleased because I believed that Mr. Castelo was fulfilling his  
4 promise to assist La Casa financially by purchasing the loan from Fidelity.

5 10. On September 23, 2015, after I reviewed the proposed loan purchase  
6 agreement and agreement transferring the deed of trust from Fidelity to Mr.  
7 Castelo, I commented to Mr. Castelo: "There is a provision in paragraph 10.6  
8 which indicates the Buyer requests that the foreclosure continue and the rights to  
9 foreclosure are transferred to the Buyer. Are you intending to foreclose on the  
10 property? If so, notify me immediately. My understanding is that you agreed to  
11 loan money to Casa de la Raza rather than purchase the loan and foreclose on the  
12 property."

13 11. Mr. Castelo responded to me as follows on September 23, 2015, at 11:47 a.m.:  
14 "It is my opinion that, with a 48-hour time fuse, there is not sufficient time  
15 allowed to explore the alternative options and formalities that may be required of  
16 us at this time. I should have been brought into this much sooner and have  
17 responded as promptly as I could!. [sic] Rather than negotiate these same  
18 provisions from scratch, I have dusted off the same documents the [sic] we used  
19 for the 2010 transaction with SBB&T. These docs were drafted by the Bank's  
20 Attorney and contain all the conventional provisions utilized by the bank for these  
21 types of transactions. I did not enforce the foreclosure clause then,  
22 notwithstanding the fact that the borrower never made any monthly payments, and  
23 do not expect it to become a factor at this time if the Board makes a diligent and  
24 good faith effort to implement their stated long term plans. It is not my intention  
25 to continue with the foreclosure action but by substituting myself for the Lender,  
26 we can now control the flow of this transaction and the Board will have ample  
27 opportunity to make good on their representations regarding the pending new  
28 foundation loan within the next 60 days (or so), in which case this will become a  
"Bridge Loan" transaction, a common practice utilized to avoid the expiration of  
third party time constraints imposed upon the parties. Most experienced investors  
familiar with the proceedings will share my opinion that it is not to anyone's  
advantage to allow a foreclosure to take place.

12. I understood Mr. Castelo's statement to mean (a) He did not intend to  
foreclose; (b) he intended to provide a bridge loan; (c) the provision in the  
agreement maintaining the foreclosure sale was a "leftover" from a prior version  
of the agreement and did not apply to this transaction, and (d) that Castelo was  
advising them as to the meaning of the content within the loan documents as their  
attorney.

13. On September 25, 2015, Fidelity confirmed payment by Mr. Castelo, in an  
email to me, as follows: "This morning, Fidelity received the full pay-off amount  
from a wire initiated by Tomas [Castelo]. Accordingly, we are moving our  
foreclosure sale date from this Monday until next Friday, October 2. Because

1 Tomas will now own the Note and the Deed of Trust, it will be his decision as to  
2 what he wants to do with the new foreclosure date.” . . .

3 16. On September 25, 2015, at 5:10 p.m. Mr. Castelo began making threats of  
4 foreclosure to me, as La Casa’s agent, if La Casa did not act as he saw fit. He  
5 also refused to reinstate the loan as promised. Instead Mr. Castelo made  
6 amorphous, undefined demands that the Board display “competence.” . . .

7 27. Based on what he said, we believed Mr. Castelo that he did not intend to  
8 foreclose on the property. La Casa worked diligently (as it had done for months)  
9 to secure the loan with Santa Barbara Foundation.

10 28. On October 21, 2015, La Casa’s full board of directors met with Mr. Castelo.  
11 I appeared by telephone and my associate attorney, Matthew Mong appeared in  
12 person. Mr. Castelo appeared at the meeting with attorney Tony Fischer. Mr.  
13 Castelo confirmed that he would provide a bridge loan and that La Casa did not  
14 have to make monthly payments during the interim.

15 29. On November 5, 2015, Mr. Castelo informed me on behalf of La Casa that the  
16 foreclosure was delayed until November 25, 2015. It was on this same day that I  
17 was informed that the note had been transferred to Mr. Castelo’s alter ego, MLG  
18 Leasing, Inc.<sup>10</sup>

19 30. MLG Leasing, Inc., at the same time, imposed various terms on La Casa that  
20 were not in the [Fidelity] Note. For example, MLG Leasing required that La Casa  
21 pass over a number of hurdles “to avoid foreclosure” and demonstrate “financial  
22 maturity” and solvency.

23 31. On behalf of La Casa, I responded to Mr. Castelo and MLG Leasing as  
24 follows: “La Casa is confused about the rationale and authorization in the loan  
25 documents to simultaneously require La Casa: (a) to make regular monthly  
26 payments under the loan; (b) to pay roughly \$120,000 in charges on November  
27 24, 2015, and (c) to maintain a foreclosure of the property on November 25, 2015.  
28 Can you please explain to La Casa the provisions in the loan documents which  
allow you to do this?”

32. Mr. Castelo responded on November 25, 2015, “Any person could have  
purchased the note and they ‘don’t need no stinking permission’ from the  
borrower or any else! Had I not taken swift and decisive action, La Casa would

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<sup>10</sup> MLG was incorporated under the laws of the State of California on May 12, 1988. According to the Statement of Information filed with the Secretary of State of California on August 28, 2015, Castelo is the Chief Executive Officer, Chief Financial Officer, Secretary, Sole Director, and Agent for Service of MLG. The business of MLG is described in paragraph 19 of the Statement of Information as “Leasing of Business Equipment and Fixtures.” Plaintiff’s Exhibit A.

1 be dealing with the buildings new titleholders by now and the ultimate big  
2 winners would be the respective attorneys. Meanwhile, the default terms and  
3 conditions of the [Fidelity] Note and Deed of Trust remain in full force and effect  
4 and I have instructed the Foreclosure Agent to continue the postponement of  
5 today's scheduled sale. I would like us to continue to move forward with our plan  
6 for the Corporate Board to submit the customary financial application forms  
7 required for a commercial loan to our selected prospective lenders and continue to  
8 have our Advisory Committee (Luis, Raul, Mike et al) formulate a 'work-out'  
9 plan that will provide a long-term resolution to the current financial morass. I  
10 will be leaving town soon and will be out of State, hoping to return sometime  
11 around December 6, 2015. You may all conduct yourselves accordingly."

12 33. On November 30, 2015, MLG Leasing's trustee executed a postponement of  
13 the foreclosure sale to January 27, 2016.

14 34. On January 9, 2016, I informed Mr. Castelo that La Casa was processing a  
15 loan application with Montecito Bank & Trust and the loan would be guaranteed  
16 by the Santa Barbara Foundation. . . .

17 35. Mr. Castelo responded to me two days later on January 11, 2015, that his  
18 attorneys would have to deal with whether to grant any further delay in the  
19 foreclosure.

20 36. Mr. Castelo's attorney, Tony Fischer, responded to me ten days later stating  
21 that any delay of the foreclosure would be conditioned upon a meeting with the  
22 potential lenders (Santa Barbara Foundation and Montecito Bank & Trust) and  
23 answers to his various questions about the status of the Santa Barbara/Montecito  
24 Bank & Trust loan.

25 37. After providing the information requested, La Casa requested that Mr. Castelo  
26 and MLG Leasing confirm no foreclosure would take place. Mr. Fischer, on  
27 behalf of Mr. Castelo and MLG Leasing, refused to do so. He communicated this  
28 to me.

33. The foreclosure sale was scheduled to occur on January 27, 2016, at 1:00 p.m.  
at 1100 Anacapa Street, Santa Barbara, California 93101.

39. On January 25, 2016, in response to the looming foreclosure, I filed a civil  
suit (Case No. 16CV00266) against Tomas Castelo and MLG Leasing, Inc. along  
with a motion for a temporary restraining order and preliminary injunction in the  
Santa Barbara Superior Court.

40. The preliminary injunction came up for hearing on February 10, 2016, and  
was subsequently denied . . . .<sup>11</sup>

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<sup>11</sup> Clarke Decl., 1:23-10:2 (emphasis added).

1 Clark's declaration is consistent with his testimony at the hearing on May 3, 2017.

2 In her declaration dated February 27, 2017, Marquez testified that (1) "I formally served  
3 as a board member and President of La Casa De La Raza, Inc. for 15 years leading up to and  
4 including when we sought out Tomas Castelo to assist us with the pending foreclosure from  
5 Fidelity;" (2) "Tomas Castelo was a co-founder of La Casa De La Raza, Inc. over forty years  
6 ago;" (3) "around September of 2015, we were facing foreclosure by Fidelity Mortgage Lenders  
7 and sought out help from Mr. Castelo to provide us with a bridge loan to avoid foreclosure while  
8 we sought favorable refinancing through the Santa Barbara Foundation;" (4) "Tomas Castelo  
9 never informed me, nor the members of the board that he was purchasing the mortgage note on  
10 the property;" (5) "the board never gave Mr. Castelo written consent to purchase the  
11 organization's mortgage;" (6) "Mr. Castelo never advised us to seek the opinion of another  
12 lawyer before he bought our mortgage;" (7) "we in the organization would routinely seek out Mr.  
13 Castelo's opinion when legal or financial disputes arose;" and (8) I always considered Mr.  
14 Castelo to be an attorney acting on behalf of La Casa when these problems did arise."<sup>12</sup>

15 Raquel Lopez, La Casa's current Executive Director, testified by declaration dated  
16 February 27, 2017, that (1) Castelo "was a co-founder of [La Casa] over forty years ago;" (2) she  
17 "always considered Mr. Castelo to be an attorney acting on behalf of La Casa when these  
18 problems did arise;" and (3) "[t]hat Tomas Castelo never informed our staff nor board members  
19 of La Casa that he was purchasing the mortgage on our property in writing until after he had  
20 completed the purchase."<sup>13</sup> The declarations of Clarke, Marquez and Lopez are consistent with  
21 their testimony at the hearing on May 3, 2017.

22 La Casa has not alleged in the Motion or its Complaint that Castelo concealed or failed to  
23 disclose material facts concerning the purchase of the Fidelity Note and Deed of Trust or the  
24 transfer of the Fidelity Note and Deed of Trust to MLG. La Casa asserts in its Motion that  
25 "Castelo defrauded [La Casa] by purchasing the note from Fidelity and then continuing to  
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27 <sup>12</sup> Marquez Decl., 1:7-20.

28 <sup>13</sup> Lopez Decl., 1:6-18.

1 foreclose on their property instead of providing the bridge loan as initially promised.”<sup>14</sup>  
2 Specifically, La Casa claims that Castelo falsely represented “that he would provide [La Casa]  
3 with a bridge loan.”<sup>15</sup> La Casa further claims that Castelo falsely represented that “the  
4 provisions of the purchase relating to keeping [La Casa] in default was merely leftover language  
5 from the last agreement he drafted.”<sup>16</sup> The weight of the evidence, however, does not support a  
6 finding that either representation satisfies the five-prong test for fraud.

7 La Casa was delinquent in its payment of the Fidelity Note and Fidelity had scheduled a  
8 foreclosure sale of the Santa Barbara Property under the Deed of Trust. La Casa did not have the  
9 funds to bring the loan current nor did it have a commitment from a third party lender to  
10 refinance the loan. By letter dated September 8, 2015, Clarke had asked the Santa Barbara  
11 Foundation for “a loan with a reasonable interest rate to ‘take out’ the [Fidelity Note].”<sup>17</sup> By  
12 letter dated September 15, 2015, the Santa Barbara Foundation had expressed a desire to assist  
13 La Casa with a loan to refinance the Fidelity Note, but it intended “to take the matter up in  
14 October and have a recommendation to the Board of Trustees at its November 12, 2015  
15 meeting.”<sup>18</sup> That was too late and La Casa had run out of options.

16 Castelo agreed to assist La Casa with the Fidelity Note. Castelo did not falsely represent  
17 to La Casa that he would provide La Casa with a bridge loan. Clarke, who represented La Casa  
18 in the negotiations with Fidelity and Castelo regarding the Fidelity Note, understood as early as  
19 September 22, 2015, that Castelo intended to purchase the Fidelity Note rather than provide a  
20 separate loan to La Casa to bring the Fidelity Note current prior to the scheduled foreclosure  
21 sale. Clarke testified by declaration he received a draft Loan Sale Agreement and a draft  
22 Assumption of Deed on the morning of September 22, 2015, and “was pleased because [he]

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24 <sup>14</sup> Motion, 26:15-18.

25 <sup>15</sup> Id. at 26:25.

26 <sup>16</sup> Id. at 26:27-28.

27 <sup>17</sup> Trial Exhibit Z.

28 <sup>18</sup> Trial Exhibit Y.

1 believed that Mr. Castelo was fulfilling his promise to assist La Casa financially by purchasing  
2 the loan from Fidelity.”<sup>19</sup>

3       Clarke’s primary concern was not whether Castelo’s purchase of the Fidelity Note was a  
4 true “bridge loan,” but whether Castelo intended to continue with the foreclosure sale once he  
5 was assigned the delinquent Fidelity Note and Deed of Trust on the Santa Barbara Property.  
6 By email dated September 23, 2015, Clarke asked Castelo about his intentions with respect to  
7 paragraph 10.6 of the Loan Sale Agreement and whether he intended to foreclose on the Santa  
8 Barbara Property. That same day, Castelo responded by email. Castelo acknowledged that the  
9 draft Loan Sale Agreement, which he said was adapted from a prior loan transaction, contained a  
10 provision permitting him to continue the foreclosure, but stated:

11       I did not enforce the foreclosure action then, notwithstanding the fact that the  
12 borrower never made any monthly payments, and do not expect it to become a  
13 factor at this time if the Board makes a diligent and good faith effort to implement  
their stated long term plans.

14       It is not my intention to continue with the foreclosure action but by simply  
15 substituting myself for the Lender, we can now control the flow of this transaction  
16 and the Board will have ample opportunity to make good on their representations  
17 regarding the pending new foundation loan within the next 60 days (or so), in  
18 which case this will become a “Bridge Loan” transaction, a common practice  
utilized to avoid the expiration of third party time constraints imposed by  
parties.<sup>20</sup>

19 Castelo did represent that “the provisions of the purchase relating to keeping [La Casa] in default  
20 was merely leftover language from the last agreement he drafted.” However, there is no credible  
21 evidence that Castelo’s statement was false, that he knew it was false when he made the  
22 statement, or that he made the statement with the intent to deceive Clarke and his client, La Casa.  
23 Moreover, notwithstanding Castelo’s stated intent to purchase the delinquent Fidelity Note,  
24 Clarke acknowledged by email on September 23, 2015, that he and La Casa also viewed the  
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27 <sup>19</sup> Clark Decl. 2:21-22.

28 <sup>20</sup> Trial Exhibit S (emphasis added); see Clarke Decl., 3:7-17..

1 transaction as a bridge loan and stated that he was “extremely pleased you are willing to  
2 purchase the Fidelity loan and move forward as Casa’s interim lender.”<sup>21</sup>

3 The court disagrees with La Casa’s claim that Castelo’s “tone changed completely” as  
4 soon as the Fidelity Note was transferred to MLG, and that he “opted to enforce those very terms  
5 by way of continuing to keep La Casa in default and in foreclosure.”<sup>22</sup> Castelo agreed to  
6 purchase the Fidelity Note to prevent immediate foreclosure by Fidelity on September 28, 2015,  
7 but it is apparent that he had no intention of becoming a permanent lender for La Casa. Principal  
8 and interest continued to accrue on the Fidelity Note after it was purchased by Castelo. Castelo  
9 had a right to immediately foreclose but he refrained from doing so.

10 By letter dated November 5, 2015, La Casa was advised that the Fidelity Note and Deed  
11 of Trust had been assigned to MLG.<sup>23</sup> By separate letter dated November 15, 2015, MLG  
12 advised La Casa that it would “consider a request to continue the foreclosure for a reasonable  
13 period, not to exceed 60 days, to permit La Casa to continue its use of the premises uninterrupted  
14 and to permit the parties to negotiate a long-term solution” so long as La Casa (1) commenced  
15 the regular monthly payments of \$4,101.38 due under the Fidelity Note; (2) “[made] a diligent  
16 and good faith effort to obtain a temporary ‘bridge loan’” in the amount of \$126,208.54, plus  
17 daily accruals, and (3) “[made] a diligent and good faith effort to obtain replacement  
18 financing.”<sup>24</sup>

19 Castelo postponed a foreclosure sale for nearly four months. During such period, La  
20 Casa was unable to secure a commitment for either (1) a permanent loan to refinance the Fidelity  
21 Note or (2) the temporary “bridge loan” referenced in the November 15th letter pending a  
22 permanent refinance of the Fidelity Note. There is no evidence that La Casa commenced the  
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24 <sup>21</sup> Trial Exhibit S.

25 <sup>22</sup> Motion, 28:19-22.

26 <sup>23</sup> Trial Exhibit M.

27 <sup>24</sup> Trial Exhibit N (emphasis added).  
28

1 regular monthly payments of \$4,101.38 due under the Fidelity Note to MLG, as requested in the  
2 November 15th letter. Ultimately, MLG elected to proceed with a foreclosure sale on January  
3 27, 2016. La Casa sought a preliminary injunction in state court to prevent MLG from  
4 foreclosing on the Santa Barbara Property, but its inability to obtain injunctive relief prompted  
5 the filing of La Casa's chapter 11 petition on February 23, 2016, to halt the continued foreclosure  
6 sale.

7 Finally, La Casa claims that Castelo was its attorney and, as its attorney, violated Rule 3-  
8 300 of the California Rules of Professional Conduct in purchasing the Fidelity Note and Deed of  
9 Trust by not securing La Casa's written consent to the transaction after (1) providing La Casa  
10 with written notice of his intention to purchase the Fidelity Note and Deed of Trust, and (2) an  
11 opportunity to seek the advice of independent counsel. Rule 3-300 of the California Rules of  
12 Professional Conduct states that "[a] member shall not enter into a business transaction with a  
13 client; or knowingly acquire an ownership, possessory, security, or other pecuniary interest  
14 adverse to a client, unless each of the following requirements has been satisfied:

15 (A) The transaction or acquisition and its terms are fair and reasonable to the  
16 client and are fully disclosed and transmitted in writing to the client in a  
17 manner which should reasonably have been understood by the client; and

18 (B) The client is advised in writing that the client may seek the advice of an  
19 independent lawyer of the client's choice and is given a reasonable  
20 opportunity to seek that advice; and

21 (C) The client thereafter consents in writing to the terms of the transaction or the  
22 terms of the acquisition.

23 Rule 3-300 is triggered when "an attorney who obtains an interest in the property of a client,  
24 where it is reasonably foreseeable that his acquisition may become detrimental to the client, even  
25 though his intention is to aid the client, has acquired an interest adverse to the client." Connor v.  
26 State Bar of Ca., 50 Cal.3d 1047, 1057 (1990); see Ames v. State Bar of Ca., 8 Cal.3d 910, 918  
27 (1973) ("We think it is clear that petitioners' purchase of the note and first deed of trust  
28 constituted an acquisition of an interest adverse to their clients.").

1 “A violation of the Rules of Professional Conduct subjects an attorney to disciplinary  
2 proceedings, but does not in itself provide a basis for civil liability.” BGJ Assocs., LLC v.  
3 Wilson, 113 Cal.App.4th 1217, 1227 (2003); see Prakashpalan v. Engstrom, Lipscomb & Lack,  
4 223 Cal.App.4th 1105, 1128 (2014) (“[A] ‘violation of the Rules of Professional Conduct does  
5 not, in and of itself, render an attorney liable for damages.’” (citation omitted)).

6 By virtue of his relationship with La Casa, Castelo unquestionably had a legal duty to  
7 disclose material facts. La Casa has not, however, alleged that Castelo concealed or failed to  
8 disclose material facts concerning the acquisition and enforcement of the Fidelity Note and Deed  
9 of Trust. La Casa’s Motion is predicated upon two false representations allegedly made by  
10 Castelo to La Casa. The court is unable to find that either representation was false; or if false,  
11 that Castelo made the false representation to La Casa with knowledge of its falsity, with the  
12 intent to deceive La Casa, and to induce it to justifiably rely on the statement to its detriment.  
13 Nor does the evidence permit an inference of fraudulent intent from Castelo’s course of conduct.

14 Even if the court were to find fraud, La Casa has failed to produce evidence that it  
15 sustained any actual damages proximately caused by such statements. “The measure of damages  
16 in a fraud action is ‘out of pocket’ loss.” Kukulka-Stone v. Ekrem (In re Ekrem), 192 B.R. 982,  
17 997 (Bankr. C.D. Cal. 1996). “[T]he defrauded party may also recover reasonable amounts that  
18 were expended because of the deceit.” Id. La Casa acknowledges in its Motion that,  
19 notwithstanding entry of default, “the moving party must still establish the amount of  
20 damages.”<sup>25</sup> La Casa’s Motion, however, does not identify any actual damages proximately  
21 caused by the alleged fraud. La Casa simply states that it “should be awarded punitive damages  
22 not less than \$600,000.00 which is the approximate value of the note purchased.”<sup>26</sup>

23 Clarke testified at the hearing that La Casa lost the opportunity to negotiate the reduction  
24 of accrued late fees and other unpaid charges in excess of \$80,000 when Castelo purchased the  
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26 <sup>25</sup> Motion, 30:25-26.

27 <sup>26</sup> Id. at 31:9-11. La Casa’s prayer in the Motion seeks a judgment “for fraud in the amount of  
28 no less than \$600,000.00 in punitive damages” without claiming any amount of actual or  
compensatory damages. Id. at 33:10.

1 Fidelity Note rather than loaning La Casa an amount sufficient to bring the loan current. But  
2 Clarke's testimony on this issue conflicts with his own emails in which stated that he was  
3 "extremely pleased" that Castelo was purchasing the Fidelity Note. More importantly, La Casa's  
4 actual damage in this regard is speculative because there is no evidence that La Casa had any  
5 agreement with Fidelity to reduce or waive such charges if the Fidelity Note was brought current  
6 or that it had even negotiated the point with Fidelity prior to Fidelity's scheduled foreclosure  
7 sale.

8 La Casa also claims that Castelo's "actions resulted in a state court action to prevent  
9 foreclosure and eventually bankruptcy related to this adversary proceeding forcing [La Casa] to  
10 incur significant legal fees."<sup>27</sup> La Casa did not plead an amount of attorneys' fees and costs  
11 actually incurred by La Casa for the period between assignment of the Fidelity Note and Deed of  
12 Trust to MLG and La Casa's bankruptcy attributable to Castelo's alleged fraud. The evidence of  
13 such attorneys' fees is also insufficient.

14 At the hearing Clarke testified that he rendered 100 hours of legal services to La Casa,  
15 billed at a rate of \$250.00 per hour, for a total cost of \$25,000 defending a foreclosure under the  
16 Fidelity Note from the time Castelo became involved until September 2016. Fidelity's scheduled  
17 foreclosure under the Fidelity Note was September 28, 2015, MLG acquired the Fidelity Note in  
18 November 2015, and La Casa filed its chapter 11 petition on February 23, 2016. Clarke did not  
19 bifurcate and identify the time spent or services rendered to La Casa for the period between  
20 September 28, 2015 and February 23, 2016. To recover for legal services rendered after  
21 February 23, 2016, Clarke would have had to have been employed as counsel for La Casa, as  
22 debtor in possession, pursuant to § 327. Because his employment was not approved by the court,  
23 Clarke is not qualified to recover attorneys' fees for legal services rendered to La Casa after  
24 February 23, 2016. Absent evidence of La Casa's attorneys' fees incurred between September  
25 28, 2015 and February 23, 2016, proximately caused by Castelo's alleged fraud, the court is  
26 unable to make any finding regarding actual damages to La Casa attributable to attorneys' fees.

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28 <sup>27</sup> Motion, 26:21-24.

1 “In an action for the breach of an obligation not arising from contract, where it is proven  
2 by clear and convincing evidence that the defendant has been guilty of oppression, fraud, or  
3 malice, the plaintiff, in addition to the actual damages, may recover damages for the sake of  
4 example and by way of punishing the defendant.” Cal.Civ.Code § 3294(a). “‘Oppression’  
5 means despicable conduct that subjects a person to cruel and unjust hardship in conscious  
6 disregard of that person’s rights.” *Id.* at § 3294(c)(2). “California courts have long interpreted  
7 Section 3294 to require an award of compensatory damages, even if nominal, to recover punitive  
8 damages.” *California v. Altus Fin. S.A.*, 540 F.3d 992, 1000 (9th Cir. 2008). La Casa is not  
9 entitled to an award of punitive damages because it has not established a fraud nor actual  
10 damages attributable thereto.

11 Based on the foregoing, La Casa’s motion for a default judgment on its sixth cause of  
12 action should be denied.

13 3. First Cause of Action – To Determine Validity and Priority of Liens

14 In paragraph 60 of its Complaint, La Casa alleges that “[o]n or about September 23,  
15 2016, [Castelo] through his alter ego MLG Leasing, Inc., violated Rule 3-300 of the California  
16 Rules of Professional Conduct by taking an adverse interest to his client La Casa De La Raza,  
17 Inc. by purchasing the note from Fidelity.”<sup>28</sup> La Casa claims that the Deed of Trust securing the  
18 Fidelity Note acquired by Castelo should be set aside because Castelo, as La Casa’s attorney, did  
19 not make the disclosures to La Casa required by Rule 3-300 before purchasing the Fidelity Note.  
20 Specifically, Castelo did not properly inform La Casa’s board of directors of his intention to  
21 purchase the Fidelity Note in its entirety, give La Casa’s board of directors a reasonable  
22 opportunity to seek independent legal advice regarding the transaction, nor obtain the written  
23 consent of La Casa’s board of directors before consummating the transaction.

24 As previously stated, “[a] violation of the Rules of Professional Conduct subjects an  
25 attorney to disciplinary proceedings, but does not in itself provide a basis for civil liability.”  
26 *BGJ Assocs., LLC v. Wilson*, 113 Cal.App.4th 1217, 1227 (2003); see *Prakashpalan v.*

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28 <sup>28</sup> Complaint, 15:19-21.

1 Engstrom, Lipscomb & Lack, 223 Cal.App.4th 1105, 1128 (2014) (“[A] ‘violation of the Rules  
2 of Professional Conduct does not, in and of itself, render an attorney liable for damages.’”  
3 (citation omitted)).

4 More importantly, MLG is the beneficiary under the Deed of Trust, not Castelo. Two  
5 requirements are necessary to invoke the alter ego doctrine: “(1) that there be such a unity of  
6 interest and ownership that the separate personalities of the corporation and the individual no  
7 longer exist and (2) that, if the acts are treated as those of the corporation alone, an inequitable  
8 result will follow.” Mesler v. Bragg Mgm’t Co., 39 Cal.3d 290, 300 (1985) (quoting  
9 Automotriz del Golfo de Ca. v. Resnick, 47 Cal.2d 792, 796 (1957)). “Among the factors to be  
10 considered in applying the doctrine are commingling of funds and other assets of the two entities,  
11 the holding out by one entity that it is liable for the debts of the other, identical equitable  
12 ownership in the two entities, use of the same offices and employees, and use of one as a mere  
13 shell or conduit for the affairs of the other.” Walsh v. Kindred Healthcare, 798 F.Supp.2d 1073,  
14 1082 (N.D. Cal. 2011) (citing Roman Catholic Archbishop v. Superior Court, 15 Cal.App.3d  
15 405, 411 (1971)).

16 To set aside the Deed of Trust, La Casa has the burden to establish by a preponderance  
17 of the evidence that (1) MLG is the alter ego of Castelo given the unity of interest and  
18 ownership; (2) that MLG participated with Castelo in a fraudulent scheme to acquire the Fidelity  
19 Note and Deed of Trust; and (3) that piercing MLG’s corporate veil to set aside the Deed of  
20 Trust, in whole or in part, is justified to avoid an inequitable result.

21 In an action to pierce the corporate veil under an alter ego theory, the corporation is a  
22 necessary party to the litigation under Rule 19(a)(1). See Bekins v. Zhelznyak, 2016 WL  
23 126729, \*4 (C.D. Cal. 2016); Wilson Metals USA, Inc., 2012 WL 5932990, \*5 (E.D. Cal. 2012).  
24 Moreover, “California law requires a quiet title plaintiff to name as defendants those persons  
25 ‘having adverse claims to the title of the plaintiff against which a determination is sought.’”  
26 Mortg. Elec. Registration Sys. v. Robinson, 45 F.Supp.3d 1207, 1210 (C.D. Cal. 2014) (quoting  
27 Cal.Civ.Proc. Code § 762.010). “‘Claim’ includes a legal or equitable right, title, estate, lien, or  
28 interest in property or cloud upon title.” Cal.Civ.Proc. Code § 760.010(a). MLG is a necessary

1 party to any action challenging its corporate existence or seeking to declare void an interest that  
2 it owns in real property.

3 Based on the evidence presented, La Casa is not entitled to a default judgment on its first  
4 cause of action because (1) it has failed to establish that Castelo committed fraud in the  
5 acquisition and enforcement of the Fidelity Note and Deed of Trust, and (2) MLG is no longer a  
6 party to this adversary proceeding. Accordingly, La Casa's motion for a default judgment on its  
7 first cause of action should be denied.

8 4. Equitable Subordination


9 La Casa did not plead a claim for equitable subordination in its complaint. As a result La  
10 Casa is not entitled to equitable subordination by default judgment. See F.R.Civ.P. 54(c) ("A  
11 default judgment must not differ in kind from, or exceed in amount, what is demanded in the  
12 pleadings.").

13 CONCLUSION

14 In sum, this court will recommend to the district court that La Casa's Motion be denied  
15 and that La Casa's First and Sixth Causes of Action against Castelo, together with its claim for  
16 equitable subordination, be dismissed with prejudice.

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24 Date: August 22, 2017

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27 Peter H. Carroll  
28 United States Bankruptcy Judge